

Interview

with Eckhard Sauren



Manager selection and diversification – the key for a long-term success in investments

Sauren Finanzdienstleistungen was founded in 1991 by Eckhard Sauren (39) and has specialised in fund manager due diligence early on. Today Sauren manages about 2.3 billion Euro in 14 funds of funds, of which two are funds of hedge funds. Since 2007 Sauren has opened a branch in Zug to give his commitment to the Swiss market.

Hedgegate (Hg): *According to your strategy, you are investing in fund managers, not in funds. Some of your competitors, on the other hand, explicitly try to avoid the “stars”, preferring team approaches instead. How can you avoid getting involved in “stardom” issues?*

Sauren: For us it is most important to really understand the investment philosophy of the decision taker. We want to know who is taking responsibility for each individual position in a portfolio and the reasoning behind the position. Team decisions rarely work. In the end you want an experienced risk taker who takes responsibility for the positions and not a consensus view of a committee. By having a thorough understanding of the kind of investments a fund manager makes, we are able to evaluate the performance in the given market environment. Should the performance deviate from our expectations we call up the manager and question him. Secondly we monitor the impact of assets under management very closely, knowing that rising assets might hinder the manager’s flexibility, especially in less liquid markets. If a manager gets too big we rather prefer a more nimble manager with an equally high quality. So the kind of managers that are perceived as “stars” in the market quite often lose appeal to us, as they have grown too big.

Hg: *How do you identify new ideas and new fund managers?*

Sauren: New ideas can come from very different sources. Quite often a manager is known to us from a previous employer. You can take Graham Clapp as an example who managed 25 billion Euros in one of the biggest European equity funds for Fidelity. When it was announced that he would leave Fidelity we immediately contacted him and were a day one investor, when he set up his hedge fund Pensato with only 40 million Euros. But we also ask fund managers who they think are good investors and visit capital introduction conferences. We are keeping our ears and eyes open to spot new ideas. And again it comes down to having the right people for finding new ideas. We have a portfolio management team of 4 people working together for more than 10 years who are supported by 3 researchers. On the contrary we hardly ever use databases to mine for new ideas, as those are likely to just show the past winners. We want to identify managers who have a high probability to outperform in the future.

Hg: *Are your portfolios limited to a certain number of funds, forcing you to be disciplined and to remove a name in order to add a new one?*

Sauren: Our portfolios are usually very diversified, as there is always the risk of a high conviction manager underperforming, but also we have enough good ideas who qualify as a potential investment. In the end we have to come to a conclusion in regard to the quality of the manager, the potential inefficiencies in the relevant market and the impact of the assets under management on the strategy of that particular fund manager. These conclusions are compared to the other managers and analysed in respect to liquidity, potential risks and diversifying effects. If we see value in adding a further position, we will do so and eliminate positions if necessary.

Hg: How quickly can you redeploy assets when you see the alpha declining on any of your portfolio managers?

Sauren: No fund manager will outperform in each market environment, so you need to be able to really understand the reason for an underperformance before you make a sell decision. The majority of the funds we hold offer monthly liquidity, some even weekly. Generally speaking we do want to invest for the long term, but we pursue a strict sell discipline. We will sell a fund immediately, if the fund manager is leaving. Further reasons to sell are, if the assets under management become too large, if we generate a superior investment idea with similar characteristics to an existing one, or if there are reasons to believe that the manager cannot sustain the level of performance. Especially in the last case it is important to stay in an ongoing dialog with the manager and for example to spot when his motivation to go the extra mile is slipping.

Hg: Funds of hedge funds are often being criticized for their fee structure. How can you convince your clients that the multiple layer of fees is justified?

Sauren: Managing a portfolio of hedge funds needs qualified analysts who understand the strategies of the specific managers so that they can ask the right questions and draw the appropriate conclusions. But you also need the legal expertise and the administrative access to handle offshore funds. We have 7 persons on the research team and 5 on the legal and administration team. However our clients surly want to see us outperform our benchmarks and we have done so in the past and work hard to do so in the future as well. This goal has not been achieved by taking excessive risk but by a sound portfolio construction and good fund manager selection.

Hg: What investors usually need is low downside correlation, with investments performing well in weak markets. In that context, what diversification benefits do/did your funds of hedge funds offer in times of turmoil (2011) and crisis (2007)?

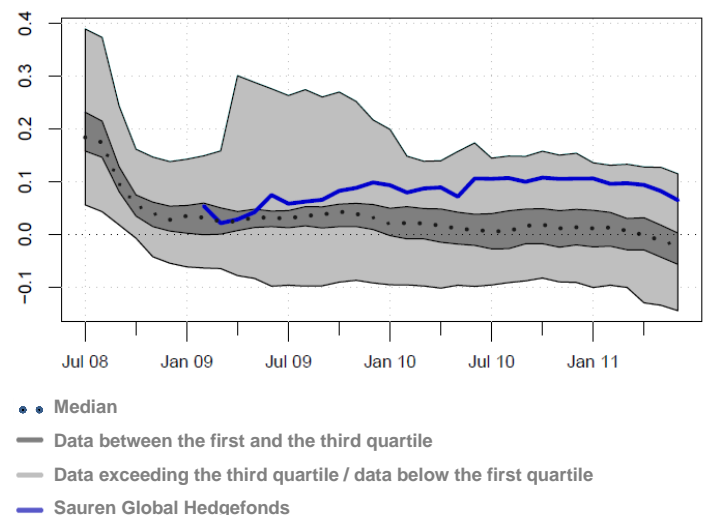
Sauren: You have to differentiate between those two market environments. Hedgefunds in general did quite well up to the collapse of Lehman Brothers. This event sent a shock wave through the whole financial system and many hedge funds were hit hard by the liquidity shock. The Sauren Global Hedgefunds lost 14,2% in 2008 compared to the HFRX Global Hedge Fund EUR Index losing 23,8%. It is also important to highlight that the fund was always liquid and could meet all redemption request.

2011 proved to be a very difficult environment so far as events like the tragic catastrophe in Fukushima, the Arab Spring and the unsolved debt issues in several developed markets led to very volatile and difficult to predict markets. With the Sauren Global Hedgefunds we could protect capital for our investors and feel very well positioned in the portfolio for the coming months.

Hg: A recent report from the Stern School of Business suggests that a diversification beyond 25 funds in a FoHF in most cases leads to a significant reduction in relative performance ("over diversification"). Would you agree with this finding?

Sauren: We currently have 23 Positions in the Sauren Global Hedgefunds and the maximum in the past was around 30 positions. If you increase the number of positions you have to ask yourself if the impact of your best ideas is still meaningful. On the other hand if you have highly specialized funds bringing a lot of volatility you probably only want a small weighting. In the portfolio construction we look for the potential alpha the individual idea may generate in comparison to the associated risk as well as the underlying liquidity and the diversifying effects the position brings.

Sauren Global Hedgefunds: Performance Score 48m (ZHAW Peer Group Report, June 2011)



Interview: ZHAW/hedgegate